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CORPORATE SOCIAL RESPONSIBILITY: DO COMPANIES HAVE
CONSCIENCES?

by
Rachel Victoria Nieters

A thesis submitted to the faculty of The University of Mississippi in partial fulfillment of
the requirements of the Sally McDonnell Barksdale Honors College.

Oxford
May 2015

Approved by

Advisor: Dr. Vicki Dickinson

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ABSTRACT

RACHEL VICTORIA NIETERS: Corporate Social Responsibility: Do Companies Have Consciences?

(Under the direction of Dr. Vicki Dickinson)

The first part of this thesis is a report that provides information on a wide variety of topics pertaining to Corporate Social Responsibility (CSR), particularly those that would be of interest to the accounting industry. All information in this report was gathered through review of research already done by prominent persons and entities in the CSR field. CSR is a combination of both environmental and social factors. In addition to government initiative support, there are a multitude of inherent benefits of CSR, as well as benefits that can only be gained through good CSR marketing. There are also costs, which can be quite substantial. Companies should decide for themselves whether CSR investment is worth the cost. Apart from some side effects, some of which can be significantly mitigated with targeted effort, CSR can be a good thing for the world overall. CSR is not going away any time soon, and it has provided and will continue to provide opportunities for the accounting industry. Because of this, the accounting industry should continue research into CSR and prepare to take advantage of the opportunities it provides.

The second part of this thesis is a summary of all the case studies we did in the fall semester of 2013, when firms visited our class to speak on a variety of topics relating to the accounting industry.

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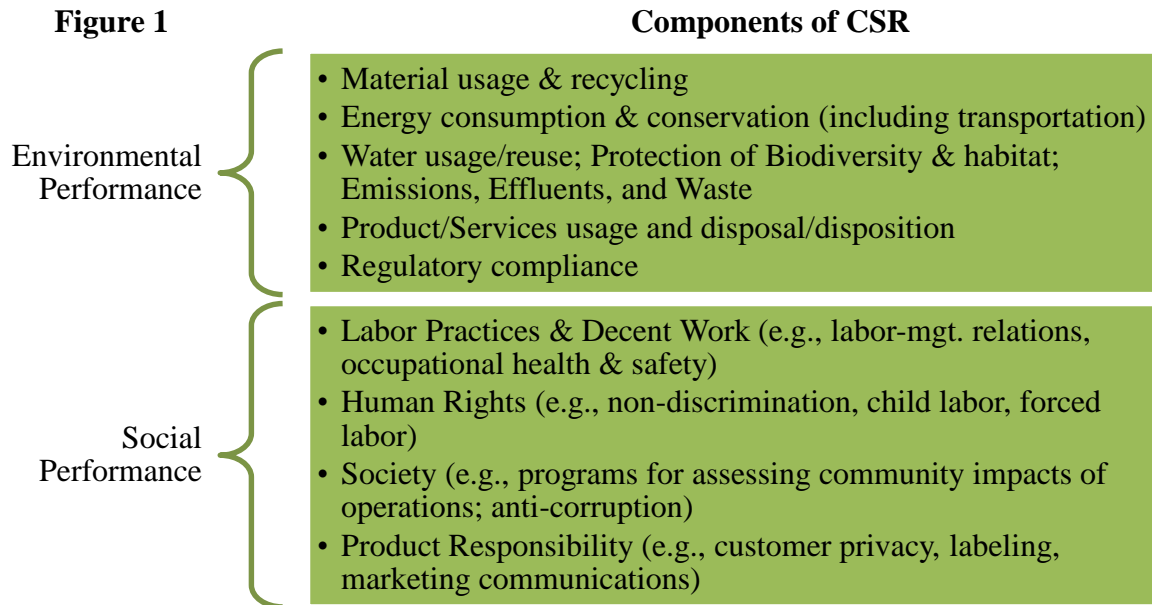
Corporate Social Responsibility

In a time of “Go Green!” trends and Nike child labor fiascos, people are looking to corporations to do something to make the world a better place. Why are people willing to pay \$3-5 (\$6-8 in an airport) for a Starbucks coffee? For some it’s the taste. But for many, it’s because Starbucks boasts of its “ethically sourced” coffee beans and teas and biodegradable coffee cups. Starbucks is all over the media for its environmental action and community service. And it is certainly paying off for them. It’s getting to the point where consumers are demanding that companies follow Starbucks’ example. Enter corporate social responsibility.

What Is It?

Corporate social responsibility (CSR) is defined by Lord Holme and Richard Watts as “the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large” (2013). This definition addresses the many aspects of what CSR is in its essence, which may or may not be the same as the way many corporations apply it to their business models. First, it is a continuing commitment. It is not something done right before financial statements are published, nor is it a movement that fades as time goes on. CSR should be a work in progress, a daily pledge, a constant thought. It is also meant to be an ethical behavior and a contribution to economic development. In other words, its purpose is to do what is considered right and to promote the health of the economy as a whole. As if these

requirements aren't enough, it should also be aimed to improve the quality of life of all those affected by the company's actions, along with their families and their communities. This piece of the definition addresses issues such as workers' rights, environmental impact, and product morality. MegaMinds Services, a financial services company based in India, brings up another aspect of CSR: the necessary balance of earning profit and looking out for the welfare of society (Holme and Watts, 2013). Boise State University breaks all of these ideas up into specific areas, each classified as either environmental or social ("Defining Ethics, CSR, and Sustainability"), as shown in Figure 1.



Source: *Components of CSR*. N.d. Graphic. Boise State University. Web. 31 Mar 2014.

Government Initiatives

Fleishman-Hillard, a globally-renowned PR firm which operates in all six inhabited continents, conducted a study in 2007 in collaboration with the National Consumers League called "Rethinking Corporate Social Responsibility." Among many other questions, it asked participants how important they deemed it for Congress to take part in ensuring that corporations are addressing important social and environmental

issues. Over 80 percent responded that they found it “extremely” or “very” important for the government to take an active role in encouraging corporations meet consumer expectations for CSR (Fleishman-Hillard and National Consumers League, 2007). Since then, both federal and state governmental entities have listened to the views of the people and passed initiatives to encourage U.S. corporations to make decisions that are socially responsible.

Most of the federal government’s foremost efforts in support of social responsibility are in renewable energy and energy efficiency. A prime example of this is in the smart grid. Energy.gov defines the smart grid as follows:

“Smart grid” generally refers to a class of technology people are using to bring utility electricity delivery systems into the 21st century, using computer-based remote control and automation. These systems are made possible by two-way communication technology and computer processing that has been used for decades in other industries. (“Smart Grid”)

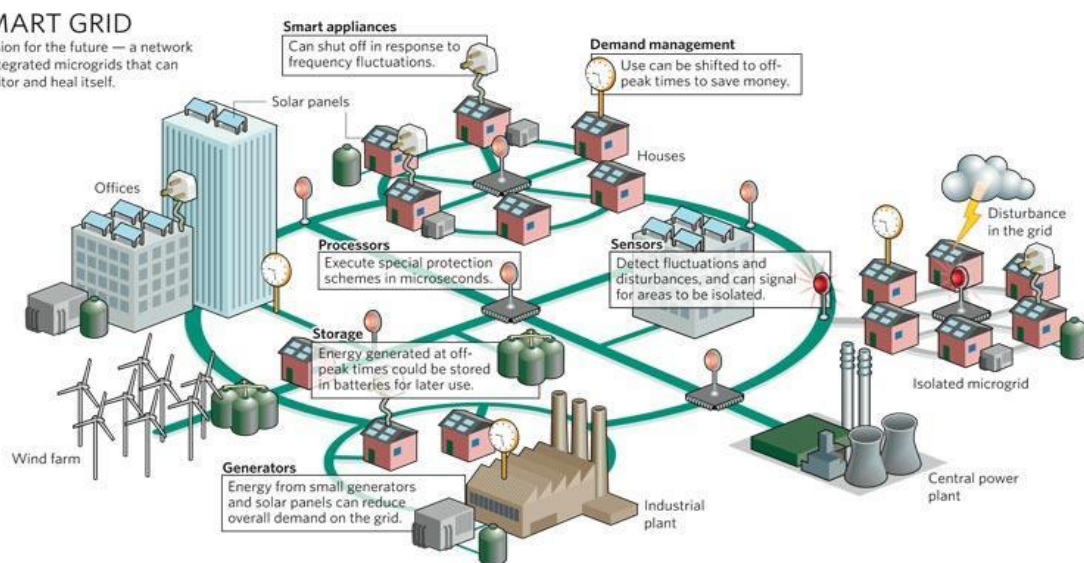
In essence, computerized sensors and meters, error detection, and auto-adjust capabilities are replacing what used to be done manually by utilities workers. Smart Grid 2030 Research Associates has diagrammed what the various components of the smart grid will look like when it is fully completed (see Figure 2). Much of the existing electricity grid is still manual, so the federal government has provided incentives for electricity utility companies to make the switch. In February of 2009, President Barack Obama signed and implemented The American Recovery and Reinvestment Act of 2009, usually referred to by its short name, the Recovery Act (“Recovery Act”). The Recovery Act covers the span of energy efficiency and sustainability, but perhaps one of the most prominent parts of

Figure 2

Smart Grid

SMART GRID

A vision for the future — a network of integrated microgrids that can monitor and heal itself.

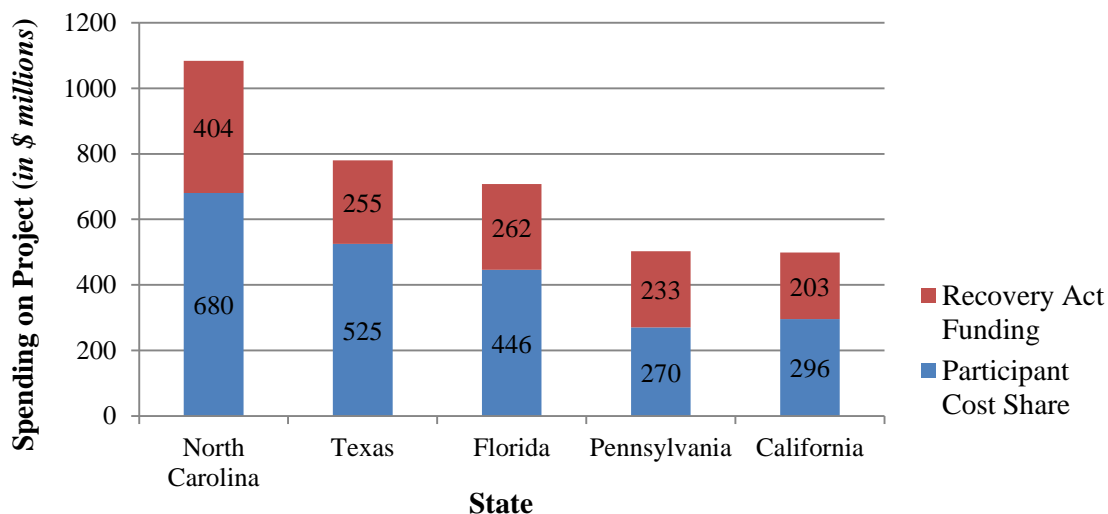


Source: *Smart Grid Overview*. 2009. Graphic. Smart Grid 2030 Research Associates. Web. 1 Apr 2014.

the act is a provision for partial funding from the government through a federal grant system for smart grid investments. Figure 3 shows the smart grid spending for the top 5

Figure 3

Smart Grid Project Spending by State (Top 5)



states by U.S. dollars spent, taken from a table published by the U.S. Department of Energy (Recovery Act Selections). North Carolina is leading the charge with over \$1

billion worth in smart grid investments from three energy projects, over \$400 million of that funded by the Recovery Act. Second and third are Texas and Florida, with over \$780 million (almost \$525 million funded) and \$707 million (over \$446 million funded) worth in total investment, respectively. Pennsylvania and California rank fourth and fifth with around \$500 million each in total investment, a little over half of that funded by the Recovery Act. The electricity grid is nowhere near being fully automated at this point. However, according to a 2010 study by the Department of Energy, if the smart grid were fully employed as planned, the reductions of CO₂ emissions in the U.S. could be as high as 18 percent, 6 percent of that being attributed to indirect results (Davidson, 2011). Not only does the Recovery Act – as it pertains to smart grids – help push the U.S. to be more energy efficient, but it encourages corporations to be socially responsible. It incentivizes the transition to a more “green” energy system, which both saves the nation as a whole money in the long run and betters the environment for future generations.

On top of smart grid grants, the Recovery Act has introduced a number of other federal initiatives relating to sustainable energy and efficiency. Additionally, there were already existing sustainable energy initiatives in place before the Recovery Act was passed. Together, these initiatives span a number of energy areas, from oil and gas to coal to renewable energy. The federal government has used a few different avenues to incentivize the investment in more sustainable energy sources: tax credits, tax deferrals, tax deductions, tax exclusions, preferential tax rates, and grants. The first five, all tax-based, are summed up in Table 1, which is a truncated version of a table in the Fiscal Year 2014 Budget of the U.S. Government (U.S. Office of Management and Budget, 2014). The category with the greatest tax expenditure in 2012 is renewable energy, with

Table 1 Energy Tax Expenditures in the United States: What Are They Buying Us?

Tax Expenditures	Target	Type	Value (\$M)		
			2007	2010	2012
Expensing of exploration and development costs, fuels	Oil & Gas	TDF	530	400	470
Excess of percentage over cost depletion, fuels	Oil & Gas	TDF	790	980	890
Exception from passive loss limitation for working interests in oil and gas properties	Oil & Gas	TDF	30	30	10
Tax credit and deduction for clean-fuel burning vehicles	Oil & Gas	TC/ TDD	260	250	100
Temporary 50% expensing for equipment used in the refining of liquid fuels	Oil & Gas	TDF	30	760	680
Natural gas distribution pipelines treated as 15-year property	Oil & Gas	TDF	60	120	110
Amortize all geological and geophysical expenditures over two years	Oil & Gas	TDF	50	150	90
Alternative fuel production credit	Coal	TC	2,920	170	20
Capital gains treatment of royalties on coal	Coal	TR	180	50	90
Credit for investment in clean coal facilities	Coal	TC	30	240	380
Partial expensing for advanced mine safety equipment	Coal	TDD	10		
Exclusion of special benefits for disabled coal miners	Coal	TE	50	40	40
Energy production credit	Renewables	TC		1,540	1,500
Energy investment credit	Renewables	TC		130	1,040
New technology credit	Renewables	TC	410		
Alcohol fuel credits	Renewables	TC	40	70	140
Biodiesel and small agri-biodiesel producer tax credits	Renewables	TC	180	20	10
Credit for holding clean renewable energy bonds	Renewables	TC	20	70	70
Credit for residential purchases/installations of solar and fuel cells	Renewables	TC	10		
Credit for business installation of qualified fuel cells and stationary microturbine power plants	Renewables	TC	80		
Qualified energy conservation bonds	Renewables	TC		0	20
Exclusion of utility conservation subsidies	End-Use	TE	120	220	270
Allowance of deduction for certain energy efficient commercial building property	End-Use	TDD	190	60	70
Credit for construction of new energy efficient homes	End-Use	TC	20	20	70
Credit for energy efficiency improvements to existing homes	End-Use	TC	380	3,190	780
Credit for energy efficient appliances	End-Use	TC	80	150	210
Credit for residential energy efficient property	End-Use	TC		220	910
Advanced energy property credit	Misc	TC		180	580
Deferral of gain from dispositions of transmission property to implement FERC restructuring policy	Misc	TDF	610	-50	-70
Exclusion of interest on energy facility bonds	Misc	TE	30	20	20
Totals (tax expenditures only)			7,710	9,930	9,500
<i>Tax Credit = TC; Tax Deduction = TDD; Tax Deferral = TDF; Tax Exclusions = TE; Preferential rates = TR</i>					

Source: Rorke, Catrina. "Energy Tax Expenditures in the United States: What Are They Buying Us?" *American Action Forum*. 27 Aug. 2013. Web. 5 Apr. 2014.

almost \$2.8 billion spent, followed by oil and gas and end-use. This is a departure from just two years prior in 2010, where end-use was the highest energy tax expenditure at over \$3.8 billion, more than \$1 billion above the next category of oil and gas, with renewable energy coming in third. In 2007, coal was the largest expenditure at almost \$3.2 billion of the \$7.7 billion spent (over 41 percent), compared to 2010 and 2012, where it accounted for less than 6 percent each year. Some of these incentives are for specific energy industries, like the oil and gas industry and the coal industry. Others span many industries, but it seems as though the two industries which have special incentives directed towards them are construction and manufacturing. While retail stores, hospitals, office buildings, and many other industries may be able to take advantage of tax credits for things such as installing solar panels or investing in a more environmentally friendly HVAC or lighting system, manufacturing and construction have specific incentives for their industries. The Energy-Efficient Appliance Manufacturing Tax Credit and Qualifying Advanced Energy Manufacturing Investment Tax Credit are just two examples of the financial incentives available for manufacturers who choose to support the sustainable energy cause (“Federal Tax Credits”; “Federal Incentives/Policies”). Similarly, the construction industry has available credits for activities such as building new energy efficient homes and commercial buildings. There are also grants available for many energy investments, such as the Tribal Energy Program Grant, USDA High Energy Cost Grant Program, USDA Repowering Assistance Biorefinery Program, and the USDA Rural Energy for America Program (REAP) Grants (“Federal Incentives/Policies”).

In addition to all these federal initiatives, every state in the U.S. has taken its own actions in regards to tax rewards for sustainability-related business. Credits for personal tax,

corporate tax, sales tax, and property tax, along with rebates, grants, loans, and bonds are available in many states. There are even performance-based incentives. Many states have really taken sustainable energy into their own hands. Figure 4 shows all of the incentives for each state, with the federal incentives at the top for comparison. The most common methods by far are rebates (548 total) and loans (206 total) across the 50 states. Utility, local, and even non-profit entities are pitching in, mostly with rebates, grants, loans, and performance-based incentives.

There is currently not a substantial amount of information available on the effect of governmental initiatives on the switch to sustainable energy, or on the reduction of energy use as a whole. Whether this is because studies have not been conducted or because there is no major effect is unclear. The difficulty in isolating government initiatives from other factors which may be affecting energy usage is also a possibility. Effective or not, it is unlikely that energy initiatives will disappear anytime soon. One main reason for this has to do with politics. In a democratic society, it can be assumed that the political process is affecting the development of these initiatives. Indeed, a study done by Alberta Di Giuli and Leonard Kostovetsky asserts that there is a natural connection between political ties and CSR. The study states: “The Democratic Party platform places more emphasis on CSR-related issues such as environmental protection, anti-discrimination laws and affirmative action, employee protection, and helping the poor and disadvantaged” (Di Giuli and Kostovetsky, 2012). Confirming these claims, the 2007 Fleishman-Hillard and National Consumers League study shows that when asked if they believed Congress should step in to make sure companies are being socially responsible, 96 percent of Democrats responded affirmatively, while only 65 percent of

Figure 4

Financial Incentives for Renewable Energy

Federal = State = Utility = Local = Non-Profit =

State	Personal Tax	Corporate Tax	Sales Tax	Property Tax	Rebates	Grants	Loans	Industry Support	Bonds	Performance-Based Incentive
Federal	3	4	0	0	0	4	6	1	0	0
Alabama	1				1		2 2			2
Alaska				1		1	3			1
Arizona	4	2	1	2	9 1		1	1		
Arkansas					1		1 1	1		
California			1	1	7 47 2		3 1 7	1		1 2 1
Colorado			2 1	3	19 2	1	2 1 2			3
Connecticut			3	2	2 2	3	7 1	2		4
Delaware					2 3		1			2
Florida		1	1	1	21 2		1 6 3	1		2
Georgia	1	1	1		15	1	1 2 1 1			3
Hawaii	1	1		1	1 1		3 1 2		1	1
Idaho	1			1	3	1	1 1		1	
Illinois			1	2	2 14	4 1 1	2		1	1 1
Indiana	1		1	1	34	1	1			1
Iowa	3	3	1	3	24		3 2			1
Kansas				1	1			1		
Kentucky	1	2	1		1 11	1	2 2 2 1	1		2
Louisiana	1	1		1	1		2 1			
Maine							2 1			1
Maryland	2	2	4	4 9	5 5		4			1
Massachusetts	1	2	1	1	6 10 1	5	1 1	2		1
Michigan				2	7	1 1	4 2 2	4		1
Minnesota			2	1	1 78	2	6 2			2 1
Mississippi					6		1 2	1		2
Missouri		1		2	15		2 2 1			1
Montana	3	1		3	4	1	1	2		
Nebraska	1	1	2	1	5		1			
Nevada			1	3	2 3		2 1			1
New Hampshire				1	3 8	2	3			
New Jersey			1	2	5	2	2	3		2
New Mexico	6	5	4	1	1		2	1	1	3
New York	2	1	3 1	3 1	7 5		3			2 1
North Carolina	1	1		2	11 1		2 3 1	1		2 1
North Dakota	1	1	3	2	1		2			
Ohio			1	2 2	10 1		3 1 2	1		1 3
Oklahoma		1		1	10		4 2	1		
Oregon	3	3		2	6 15	3 1	2 7	1		1 1

Continued on next page

Figure 4 (continued)

Pennsylvania				1	1 7	8 2	8 1 5	3		1
Rhode Island			1	2		2	1			1
South Carolina	2	2	1		5		1 4	1		1 1
South Dakota			1	2	9		1 2			
Tennessee			1	2	1	1	2 1	2		2
Texas		1		1 1	28 2		2 1 1	1		1
Utah	2	2	1		4		1	1	1	
Vermont		1	1	2	1	1	1			1 2
Virginia	1			1			2 1	3		3
Washington			1		13	1	8 1	1		1 3
West Virginia		1		1	1					
Wisconsin	1	1	1	1	3 7	1	1 2			2
Wyoming					7		1			
District of Columbia				1	1		1			1
Totals	44	42	47	81	548	52	206	39	5	76

Source: *Financial Incentives for Renewable Energy*. Graphic. Database of State Incentives for Renewables & Efficiency. Web. 1 Apr. 2014.

Republicans agreed (Fleishman-Hillard and National Consumers League, 2007). In looking at the corporations' side of this question, it becomes clear that political affiliation still applies. According to Di Giuli and Kostovetsky's study, Democratic affiliation (Democratic CEOs, directors, founders, and headquarters in Democratic-leaning states) is linked with a higher CSR score. Not just that, but S&P 500 firms with more Democratic connection tend to spend \$80 million more on CSR than their Republican-affiliated counterparts, which accounts for around 10 percent of net income (Di Giuli and Kostovetsky, 2012). It is clear that there is a political influence on CSR; another question asked, however, is if there is a demographic (urban/rural, age, gender, socioeconomic class) connection. At this point in time, there is no study with findings conclusive enough to connect demographics to CSR initiatives or spending.

Why Engage In CSR?

With CSR being such a big topic as of late, all companies should be assessing whether or not CSR investment and reporting is something that they should participate in. A recent study in 2013 by the Global Reporting Initiative (GRI) showed that of the world's largest companies, 95 percent produce some type of sustainability report ("The External Assurance," 2013). Of course, this doesn't mean it would be wholly beneficial for every company. The decision requires an evaluation of the costs and benefits associated with CSR. A qualitative analysis can be easily performed to compare costs and benefits. As with any project or investment, there are significant initial costs. This cost analysis can be divided into two situations: environmental CSR investment and social CSR investment. For an environmental CSR investment, the main cost is upfront: new equipment, system improvement, etc. The only main recurring costs are equipment or system maintenance. For a social CSR investment, the largest cost is going to be recurring. These costs can be a variety of things, from increased wages and benefits to CSR certification costs (usually a monthly or yearly fee) ("Costs and Benefits," 2012). Other general costs apply to any CSR investment situation. The costs may include assurance fees, information gathering and tracking costs, and additional investment costs (when a company is publicly reporting CSR investment numbers, they will generally spend more on CSR investment) (de Villiers and Marques, 2013). The qualitative benefits to CSR investment are copious. These can be divided into internal versus external benefits, as shown in Table 2 (developed from "Costs and Benefits" 2012; de Villiers and Marques, 2013). On top of these benefits, one statistic demands to be heard. In the Fleishman-Hillard/National Consumers League study, when asked what the most

Table 2

Internal	External
<ul style="list-style-type: none">• More committed existing employees (increased skill level and effectiveness)• Attract more highly qualified employees• Employee work effectiveness• Lower cost of recruitment• Lower worker turnover• Reduced penalty payments for environmental/labor law noncompliance• Less labor disputes• Error reduction• Improvement in quality	<ul style="list-style-type: none">• Positive reputation• Credibility• Improved relationships with government officials, retailers, customers, etc.• Improved supplier relationships• Better capital available at lower cost• More market access• Enhanced customer satisfaction• Enhanced general community environment that the business operates in• Higher market prices• Increased revenue

important factor was in determining loyalty assuming high quality, the most common answer at 35 percent was that the maker of the product was socially responsible. This answer was 15 percent higher than the next highest answer of “lower price” at 20 percent (2007). It is true, the costs cannot be ignored. However, if the costs are feasible for a company, the benefits are almost immeasurable.

Costs associated with CSR are straightforward to measure. However, because of the numerous factors involved in earning revenue and the difficulty of measuring public view and reputation, measurement of benefits associated with CSR reporting is extremely challenging, if not impossible with the current knowledge and information available. Although theoretic research tends to conclude that CSR investment leads to increased company competitiveness, there is a lack of number-based measurement standards for this correlation (Weber, 2008). Manuela Weber was disturbed by this fact, and in 2008 went about attempting to find a measurement for CSR-related benefits. Weber studied Royal Philips Electronics, headquartered in the Netherlands, one of the biggest

electronics companies in the world. After developing her own formula for CSR cost-benefit measurement (Figure 5), Weber found that the financial data for the benefit side of her formula was not available. Weber concluded that because of the lack of monetary benefit data, analyzing just the cost data part of her formula “was not regarded strategically relevant for project success” (2008).

Figure 5 CSR Formula

$$\text{Monetary CSR Value Added} = \sum_{n=1}^{n=\infty} (B_n^{CSR} - C_n^{CSR}) * \frac{1}{(1+i)^n}$$

With n = period, B^{CSR} = CSR benefits,
 C^{CSR} = CSR costs, i = discount rate.

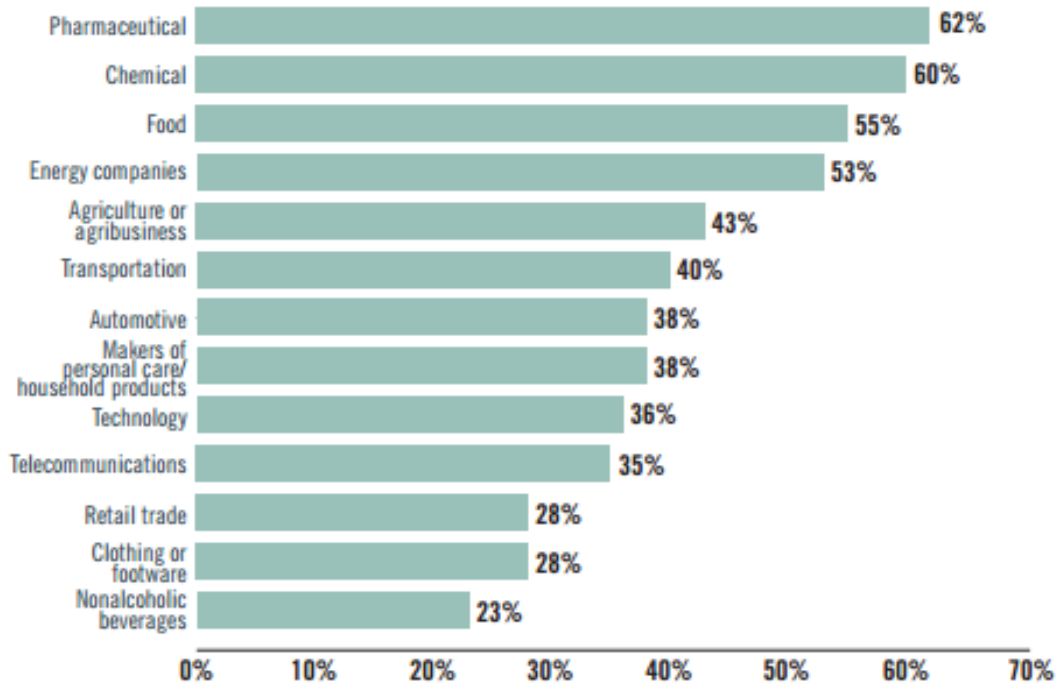
Source: Weber, Manuela. “The business case for corporate social responsibility: A company-level measurement approach for CSR.” *European Management Journal* 26 (2008): 247–261. Washington.edu. Web. 7 Apr. 2014. PDF file.

Weber’s report ends with a look forward: “future research is needed to provide more insights into the concrete measurement and isolation of CSR indicators” (2008).

In the Fleishman-Hillard/National Consumers League study, participants were asked which industries needed the most government oversight to ensure socially and environmentally responsible behavior (2007). The results of the survey are shown in Figure 6. Note that consumers identified 13 industries which they believed the federal government should pay special attention to. Standing out above the crowd, the four industries that more consumers than not think need to be more socially responsible are (in order): the pharmaceutical industry, the chemical industry, the food industry, and the energy industry (2007). If a company is in any of these 13 industries, especially the top 4, it would be wise to make as many CSR investments as it has the resources for.

Engaging in CSR reporting is a costly process. Why should a firm spend money on CSR when that money could be used elsewhere? For a small or medium sized company, that’s a fair question. Many of the benefits gained by participating in CSR reporting are immeasurable and indirect. For some companies, the costs might outweigh

Figure 6 Industries Requiring “More Oversight”



Source: *Industries Requiring “More Oversight.”* 2007. Graphic. Fleishman-Hillard and National Consumers League. Web. 1 Apr 2014.

the benefits. But for many, especially large corporations, it would be more detrimental *not* to participate. Any large corporation knows that a negative social image is damaging to profits, customer satisfaction, and employee recruitment. With so many of today’s customers calling for CSR participation in companies they buy from, a corporation’s CSR involvement and reporting is going to be highly researched and viewed. Having no CSR participation, or worse, using CSR as a marketing ploy without using actions to back it up, could destroy a company’s public image.

Marketing for CSR is a delicate balance. On one hand, a company needs to let its customers know what it is doing to be environmentally and socially responsible. The external benefits of CSR investment will be severely reduced if a company’s customers don’t know what it is doing to be environmentally friendly. On the other hand, if a

company uses CSR marketing in an attempt to reap those benefits without actually doing any CSR investing, the repercussions could be worse than they would be had the company done nothing at all. Some tips for marketing CSR are given by the Government of Canada (“Corporate Social Responsibility: Marketing,” 2011). The first step is to collect information. Compile all of the facts and figures from the company’s CSR investments into one report or location so these numbers can be easily utilized. The second step is divided into a four-faceted plan summarized by the acronym “C.R.E.D.” Part one is that the marketing must be credible. Ensure that all statements are true and able to be supported by evidence, quantitative if at all possible. Part two is that it must be relevant. A company’s green efforts should be related to its pre-CSR impact on the environment or community. For example, a car manufacturer’s donations to help soybean farmers in Africa, especially if that company has a record of fuel inefficient cars, will have little chance of being effective because it is not relevant to its business model, nor is it working towards fixing the very problems it is creating. Part three is that the message should be effective. Message effectiveness can be improved in two ways. First, it will be more effective if it is something customers can wrap their minds around. Percentages, or smaller numbers over smaller periods of time, are often more effective than total numbers. For example, it is probably more effective to say that a business’s factories use 20 percent less energy than to say they use 20 million less kilowatts per year. Secondly, a message’s effectiveness can be increased through its medium. Some audiences might be more likely to follow a social media campaign than listen to a radio broadcast. Part four is that the message should differentiate a company. To do this, a marketing campaign should be unique from other campaigns on the market. If a CSR marketing campaign is

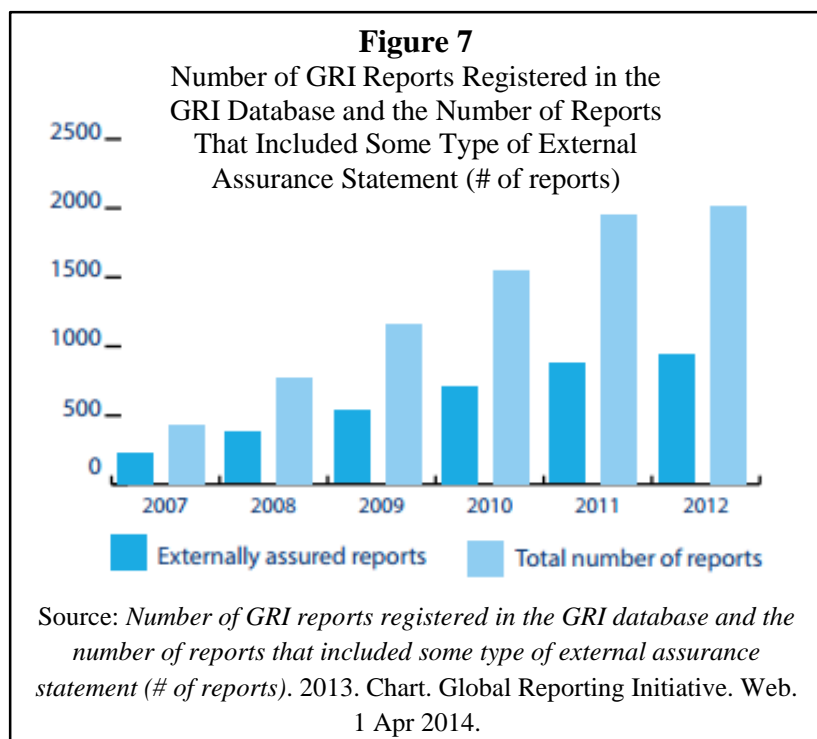
done well, it will often lead to even more “free” marketing. Magazines, newspapers, and news channels often cover the latest trending CSR campaign, and this will attract attention to a company and its CSR efforts (2011). There are so many benefits to a well-done CSR marketing campaign. Indeed, many of the general benefits associated with CSR cannot be gained without good marketing.

Assurance and CSR

With the rise of consumer demand for CSR reporting and the need for verification of that reporting, CSR provides a lot of opportunities for assurance work. One opportunity is through certifications such as AA1000AS, ISAE3000, and GRI standards (Scott, 2007). Global independent entities write their own standards of reporting for CSR, and companies can pay to be certified in those standards if they meet the set requirements. Because of the extensive inspection of the company’s business processes and CSR work necessary before certifying that company, these independent entities need a lot of assurors. Many companies may decide not to attempt to qualify for these certifications, which is a rigorous process. Very commonly, however, a company will hire its own independent auditors to attest to its CSR report and activities. Though this assurance comes mostly from accounting firms, even engineering firms and sustainability service firms are hired for expertise and certification (“The External Assurance,” 2013). This provides many assurance opportunities in association with CSR reporting.

This begs the question: why do companies need to hire assurors? According to the Corporate Register, the benefits can be summed up into three things: enhanced credibility, demonstration of commitment, and expert suggestions for improvement (Scott, 2007). Just like assurance for financial reporting, having an independent third

party attest to a company's CSR reporting strengthens the credibility of the report. In addition, hiring a CSR assurance firm demonstrates a company's commitment to honest and effective CSR because the company is opening their sustainability initiatives and CSR investment records up for scrutiny by professionals. Because of this openness, the company has the opportunity to get expert opinions on its CSR work and can gain considerably from these experts' suggestions for improvement and other recommendations. GRI adds that reduced risk, increased CSR engagement by C-level executives, and enhanced communication with stakeholders are also large benefits ("The External Assurance," 2013). From 2007 to 2012, the number of CSR reports submitted to the GRI database has increased from around 450 to almost 2000 (Figure 7). On a consistent basis, about 50 percent of the reports have included some type of external assurance statement. In 2012, this number was about 46 percent (2013). With the



growing number of assured reports, assurance work available is only going to increase over the next few years.

When a company hires an accounting firm or sustainability service firm to attest to their CSR report, a highly intensive process must be undergone before that attestation can be given. First, it must be staffed correctly. The usual partner, manager, senior staff member, consulting services partner and second audit partner will be necessary (Robertson and Louwers, 1999). In addition to this, if a company is claiming federal or state tax credits for CSR energy investment, a tax partner is needed to oversee the investigation of this. Most of these individuals should be focusing on the “audit” part of the engagement by making sure that the investment numbers a company is reporting are accurate. However, this is not the only important part of an assurance engagement; the other big piece is an analysis of the efficiency of a company’s systems. Because of the nature of a CSR assurance investigation, industry specialists play an extremely crucial role in this area. A CSR specialist, perhaps an environmental expert or social impact expert, needs to look at what the company is putting its resources into and see if that is the most effective and efficient way to accomplish its goal. Some of the control risks which are most applicable in CSR are cash flow, new technology and equipment, and foreign operations. Because a big part of CSR is investment, there is often a large flow of cash going out of the company and into whatever CSR activity it is investing in. This is going to be true for almost every socially and environmentally responsible company. For a lot of companies, this is because of new technology, equipment, or machinery. This is common in the manufacturing and energy businesses. Often, manufacturing plants will invest in machinery that reduces energy, material, or water usage. Similarly, many energy companies invest in new technology that will help them get energy from more sustainable, environmentally friendly sources or will help them mine coal or pump oil in

a way that does less damage to the environment. For the companies that are trying to invest in socially responsible ways, this will likely involve a lot of cash flow to foreign countries, whether to increase wages or to pay a slightly higher price to switch to a smaller, local, more organic supplier. The assurance team must keep in mind these specific risks when performing the analysis. The specific evidence required to attest to the report will mostly be source documents. If a company claims to have invested in more energy-efficient equipment, there should be a purchase invoice, and a team member should go to the factory and inspect the equipment. If the company has taken a more attitude-based approach (versus an investment-based approach), documentation will be more difficult to find. In its place, employee interviews are extremely helpful in confirming that the company is behaving in the way it claims to be. In addition, interviews with suppliers could be helpful if the company claims to be paying more for a more organic product. In theory, there should be some type of proof for every claim that a company makes, whether it's documentation or interviewing employees and suppliers. However, because interviews with employees are difficult to prove or quantify, the general assurance report for CSR provides a "limited" level of assurance. This is generally shown in the report by a statement similar to the following:

Based on our review, nothing has come to our attention that causes us to believe that the selected quantitative performance information... is not presented fairly in accordance with the relevant criteria. (Scott, 2007)

In many of these limited assurance reports, the assurance team will "flag" any part of the CSR report which it cannot attest to (such as employee satisfaction, which is difficult to prove). In some cases, there is a legal disclaimer which tells the reader not to rely on the

information in the CSR report when making critical financial decisions (2007). CSR attestation is still unregulated, and investors should maintain reasonable skepticism when reviewing these reports, whether assured or not.

Investment and CSR

One of the big topics in CSR in the last few years is socially responsible investing (SRI). In September 2009, Executive Director of the United Nations Global Compact Georg Kell addressed the Dow Jones Private Equity Analyst Conference in New York:¹

Incorporating ESG (Environmental, Social, and Governance) issues into investment analysis, and improving the management of ESG issues within all companies and assets in the portfolio, can help maximize long-term investment objectives – while, at the same time, aligning the investment community with larger societal goals. In other words: a double dividend. (qtd. in “UN Global Compact Executive Director,” 2009)

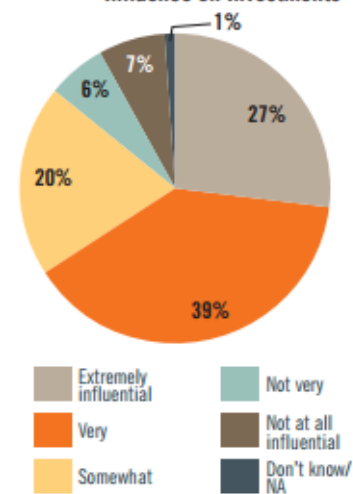
It turns out that SRI might be a “double dividend,” indeed. The Global Compact did research on companies that were publically listed with the Global Compact to see if there was a correlation between intensity of CSR initiatives and financial performance. Companies that attained a “notable” recognition on their annual Communications on Progress (COP)² were constantly an average of 7.3 percent higher than the MSCI World Index from 2007 to 2009 (“UN Global Compact: Notable Performers,” 2009). The Global Compact concluded that “there is a clear correlation between publicly listed companies

¹ The UN Global Compact describes itself as “a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption” (“Overview of the UN Global Compact,” 2013).

² “Business participants in the UN Global Compact commit to make the Global Compact ten principles part of their business strategies and day-to-day operations. Companies also commit to issue an annual Communication on Progress (COP), a public disclosure to stakeholders (e.g., investors, consumers, civil society, governments, etc.) on progress made in implementing the ten principles of the UN Global Compact, and in supporting broader UN development goals” (“What is a COP?” 2014).

that disclose ESG information under the Global Compact’s framework and the resiliency of their stock market valuation over the long term” (2009). This is good news for many companies that report their CSR information, especially under the various certifications mentioned earlier. Other studies are suggesting the same thing. Many of the benefits listed earlier (refer back to Table 2) are either classified as better financial performance or are directly related to better financial performance (de Villiers and Marques, 2013). If a pension fund is looking to get better returns, CSR appears to be a good way to do it. Many investors have realized this. The Fleishman-Hillard / National Consumers League study asked participants how influential a company’s CSR record would be when deciding whether or not to invest in a company (2007). Figure 8 shows the results of that survey question. About 66 percent said it would be “extremely” or “very” influential, and only 13 percent responded “not very” or “not at all.”

Figure 8 CSR's Record's Influence on Investments



Source: Fleishman-Hillard and National Consumers League. *CSR's Record's Influence on Investments*. 2007. Chart. Web. 5 Apr 2014.

Ethical Considerations

CSR is an inherently ethical concept. It’s about doing the right thing for the environment, for the people affected by a business, and for society at large. There are, however, some other ethical considerations. Perhaps one of the most obvious stems from the lack of mandatory CSR reporting standards. While there are a lot of available

certifications and hiring an assurance firm is a possibility, these are both completely voluntary. In theory, a company can publish whatever it wants in its CSR report, or choose not to report at all and do a hoax CSR marketing campaign. Apart from being unethical, this is also highly risky. If customers, investors, or the media found out, it could become the next WorldCom, sans jail time. Humor aside, the negative publicity could be potentially detrimental to the company. Considering only around 50 percent of CSR reports have external assurance statements, this is a real possibility. One can only hope that companies would not fake good deeds for a profit. On a smaller scale of the same issue, it is also possible for companies to find loopholes in CSR reporting recommendations so it is less likely for the falsehood to be exposed. This is an issue that will likely be addressed by a governing body in the future as CSR continues to grow. Another concern with CSR is motive. Companies are more likely to voluntarily disclose information when it directly benefits them. On the flip side of that, companies are highly *unlikely* to voluntarily disclose information which is harmful to them. This begs the question: how truthful, transparent, and consistent can CSR reports really be? Nothing is stopping a company from reporting everything it does well (or fabricating it) and leaving out the parts that are lacking. At that point, is the company really looking out for stakeholders' interests? This brings up more questions. Companies are obligated to earn profit for their shareholders, but how far should they go to do that? Is it ethical to fudge the CSR report because it's not technically against the law? These are questions that companies are asking, and customers, investors, and general members of society should be asking themselves the same questions. Those who consider CSR information before

investing in a company or purchasing from them should take any information they find with a grain of salt.

Side Effects

The aim of CSR is to contribute to more healthy people, environment, and society. However, the CSR trend as a whole might have unintended consequences, ranging from unfortunate to completely counterproductive. One consequence, pointed out in a research paper published by Smith, Palazzo, and Bhattacharya, is that CSR places so much emphasis on corporations that the individual consumer is beginning to let go of much of the responsibility of environmental protection (2010). While corporate entities do have a lot of influence and their work is essential to protecting the environment and human rights, if every individual person at home stopped recycling or reducing their car usage or unplugging their electronics when not in use, the environmental issues would erupt. There is more to being environmentally responsible than just buying products from CSR-involved companies. A huge issue pointed out by Henderson is that CSR could potentially be destroying development in developing countries (2001). Henderson cites the example of a well-known company, Levi Strauss. As Levi Strauss started putting more resources into CSR, the result was the opposite of what its managers intended: factories in third world countries had to shut down, leaving masses of people jobless. If international CSR policies like labor pay standards are put into place, the effect will likely be lower employment rates so that costs don't go up. In addition, money that was previously spent on technology, employee training, and development would now have to be spent on CSR enforcement, reporting, and assurance fees. While CSR is a good thing

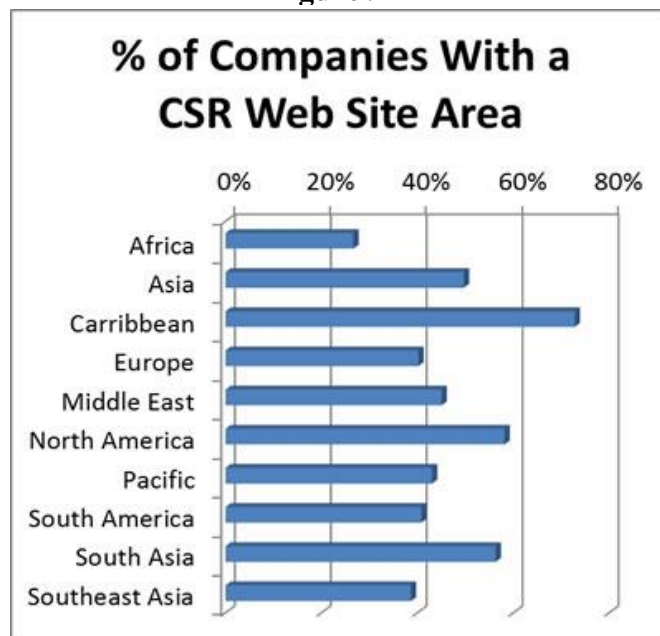
in concept, it needs to be applied and advertised strategically to avoid unintended consequences.

CSR Around the World

CSR is a truly global matter. As referenced earlier, there are a few reputable global entities which promote CSR and have strict standards for CSR reporting. The major one is the UN Global Compact. It is a strict and selective organization which only allows membership to companies that meet its high standards. When consumers were asked how necessary global standards are, over 75 percent responded that they were “extremely” or “very” necessary, according to the study done in 2007 by Fleishman-Hillard and the National Consumers League (2007). Not only that, but two out of every three say that a company’s adherence to global standards would be “extremely” or “very” influential to them purchasing from that company (2007). At this time, however, being certified according to global CSR standards is completely voluntary. Each country, and each company within that country, is free to do with CSR what it wishes. So, where does the U.S. rank in CSR compared to the rest of the world? This can be broken up into three categories: marketing, assured statements, and spending. According to a survey done in 2012, just under 60 percent of companies in North America have a CSR area on their company websites (refer to Figure 9). This is the second highest percentage, with CSR-advertising companies in the Caribbean area reaching over 70 percent of the total Caribbean companies. South Asia is in a close third, and areas like Europe and South America are lower, around 40 percent. Africa, in dead last, is about 20 percent, which is not surprising considering that many of its countries are still developing. In the category of assured statements, the U.S. is a little lower. The Corporate Register puts the U.S. up

against four other countries it is often compared to in regards to business and the economy (refer to Figure 10). In this category, the U.S. is behind its main competition. The U.K. is in a solid lead, with 57 percent of its reports being externally assured. Japan, a rapidly developing center of business, is at just under 30 percent. The U.S. is

Figure 9

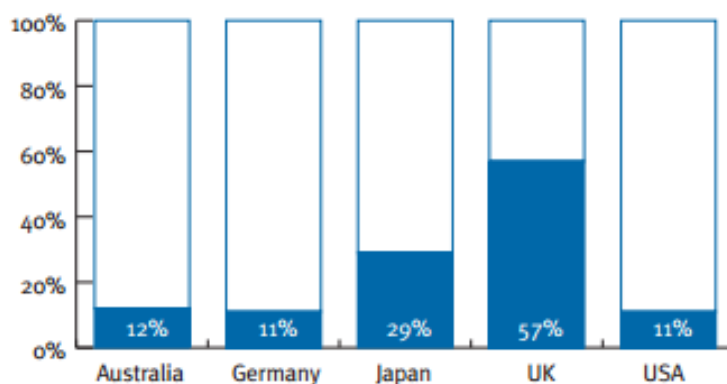


Source: Gidwani, Bahar. *% of Companies With a CSR Web Site Area*. 2012. Chart. CSRHub. Web. 1 Apr 2014.

right in line with countries like Germany and Australia. These results could have many factors, including how developed CSR assurance is in each country. In the final category, overall spending, the U.S. blows the competition away. Again in Figure 11, the U.S. is shown with some of the typical countries it is compared to: Australia, the U.K., and

Figure 10

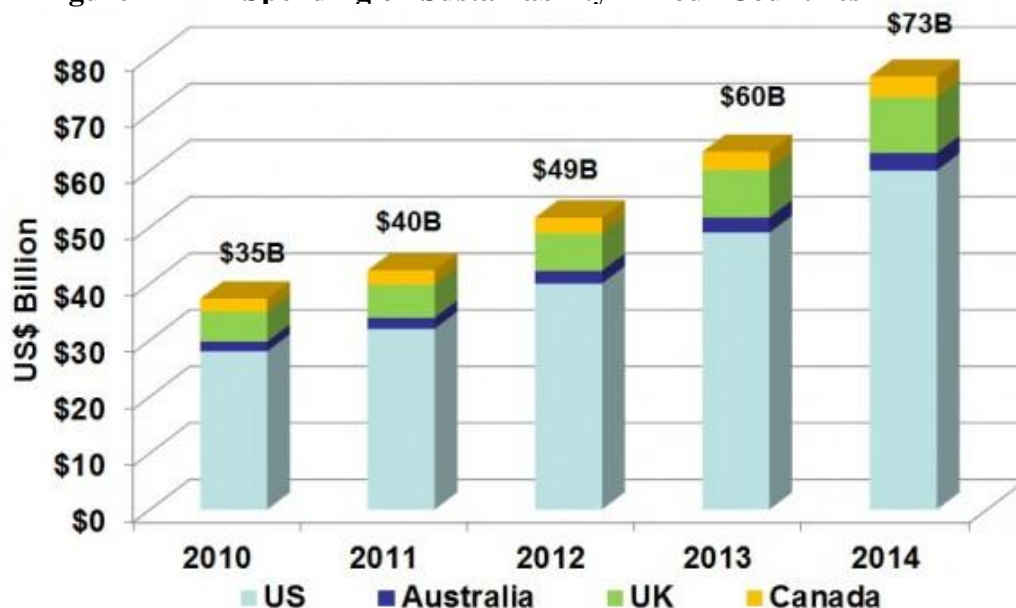
% of CSR Reports with External Assurance from Top 100 Companies Across 5 Countries (2007)



Source: Scott, Paul. *% of CSR Reports with External Assurance from Top 100 Companies Across 5 Countries (2007)*. 2007. Chart. CorporateRegister.com. Web. 1 Apr 2014.

Canada. Since 2010, the U.S. has spent more than twice what the other countries have spent combined. Total spending for the four countries in 2014 is predicted to be an astounding \$73 billion, up

Figure 11 Spending on Sustainability in Four Countries



Source: *Spending on Sustainability in Four Countries*. 2013. Chart. Triple Pundit. Web. 1 Apr 2014.

\$13 billion from 2013. Country comparison aside, it is important to note that the companies in each country shown are spending more and more each year. No matter who it comes from, \$250 billion dollars into the environment and worldwide communities is an astonishing number. And that's just from the last five years in only four countries!

Another major point of comparison between the U.S. and other countries is governmental CSR policy. While the U.S. has various federal environmental initiatives (almost exclusively in sustainable energy), it has no legislation for CSR as a whole. There are many other countries without CSR policies, hence the need for the UN Global Compact as a worldwide effort. There are, however, forward-thinking countries that have already adopted written CSR policy which is, arguably, somewhat strict. India is a prime example. In 2013, the Parliament of India passed the New Companies Act (Holme and Watts, 2013). A portion of that act addressed CSR, making it mandatory for a company

with a net worth of over Rupees 500 Crores (about 82.9 million USD) or having a net profit of over Rupees 5 Crores (about 830,000 USD) to participate in certain CSR-specific activities. These activities include forming a CSR committee on the Board of Directors (no less than three directors, one of which must be independent), creating an official company CSR policy, and spending no less than 2 percent of average net profit over the last three years on CSR investments (2013). Another comparison to the U.S. is Mexico. While the Mexican government awards excellence in CSR with prizes, there is not a very strong policy-based initiative for CSR activities, leaving it to the corporations to take action, which very rarely includes small to mid-sized companies (“Mexico,” 2012). The U.S. is in line with many other countries which lack laws regarding CSR. Whether that puts U.S.-based companies at an advantage or disadvantage compared to companies based in countries like India is a matter of opinion, as the current information available gives no clear evidence that governmental CSR policy helps or hurts corporations’ CSR work.

No one can deny that CSR is a major topic or that its effects are impactful. Whether they are impactful in a positive or negative way is up for debate. Regardless, CSR is something every company needs to evaluate for itself, and every consumer needs to take a stance on, because the reality is that it’s changing our world. Might as well be part of it and make sure that change is for the better.

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Professional Development and Speaker Series

Rachel Nieters

This portfolio is a summary of the cases and competitions compiled during Fall 2013 in conjunction with ACCY 420.

Summary and Highlights

• • •

The most important lesson I learned is that accounting is more gray area than black and white. This isn't to say that everything is a judgment call, though much of it is; I'm saying that it's not as set-in-stone as many people think. It is always adapting to the next big thing, a new technology, a rising industry. Tax codes and standards change yearly, and you have to keep up with them. But more than that, you have to constantly be on your toes, being able to apply the new rules—as well as the old ones—in a way that is beneficial to the client (or to your company or yourself). Knowing and reciting the codes is not enough. I'm going to use this new knowledge to really excel in my learning. I won't memorize tax code, I'll learn it inside and out so I can apply it. This will help me not only in school, but also in my career.

PwC, September 12

Ken Verheek
Partner, Assurance
Houston, TX

Brent Ellis
Managing Director, Tax
Houston, TX

George Bordelon
Experienced Associate, Assurance
Dallas, TX

Corey Edgar
Campus Sourcing
Dallas, TX

Summary of the case

The state of Westmead is facing a tax-related crisis. Revenue from the “gas tax” has decreased because of two reasons:

- 1) Automobiles have better gas mileage overall, and
- 2) Nearly 25% of Westmeadian cars are alternatively-powered

Because electric and alternative-energy cars don’t use gas, they are putting wear on the roads, but not paying taxes because they bypass the gas tax. Westmead needs to come up with ways to fund this revenue shortfall and redistribute tax collections to *all* cars.

Our solution

Our solution is to tax tires. This would be a replacement tax, not an additional one. If the tax is included in the price of the tires, much like it is in the price of gas, many will hardly realize that they are paying tax. Tires are a necessity for every vehicle, so alternative-energy cars will still be paying the same as gasoline-using cars; this fits because the two types of vehicles put the same wear on the roads. Also, this way, semis are paying more tax because they are putting more wear on the roads.

What I learned

I learned that the new electric car push has a lot of tax effects that many people, including myself, don’t realize. This led to my recognition that many of the new trends and movements, even things such as Go Green recycling and energy-saving methods, as well as alternative energy methods such as solar panels, could have major tax and economic implications. The government has to get creative with fairly distributing the tax

responsibility, as well as balance that with trying to encourage environmentally-aware behaviors with tax breaks. I also learned that there are different (sometimes many) ways to accomplish the same goal, and the best system often changes with new technology, or new ways of doing business. Accounting is always adapting to the next rising issue.

BKD, September 19

Linda Trifone
Senior Manager, Audit
Jackson, MS

Thad Burke
Senior, Tax
Jackson, MS

Matt Glover
Senior, Audit
Jackson, MS

Chandler Croom
Staff, Audit
Jackson, MS

Summary of the case

The assistant to the CEO of a non-profit organization had access to everything the CEO had access to. Therefore, she was able to redirect donations to herself, forge the CEO's signature on documents, make journal entries to cover her tracks, submit her children as fake "children in need" to write them checks, steal from the petty cash fund, approve her own overtime, and many other offenses. She started living above her means, including buying an expensive recreational vehicle and multiple laptops, and paying for her nose job. What procedures or controls could be put in place to prevent things like this from happening?

Our solution

We decided on a multifaceted solution. First off, the assistant has access to too many parts of the business. Either some of her related duties need to be reassigned to someone else, or there needs to be an independent double-signer (*not* the CEO). In addition, there should be a comparison between her overtime hours worked from year to year and a double-check on donations. She should not be the sole manager of the petty cash fund; that responsibility needs to be shared with someone else. Lastly, there needs to be an independent auditor who does random checks to make sure nothing looks off.

What I learned

I learned how easy it is to steal large amounts of money little by little when there aren't proper checks in place, and how many different parts of a business need controls. I hadn't realized there were so many potential access points for fraudsters. I also learned the

importance of an external auditor; there's no way of knowing who is involved in fraud, even the CEO. You need someone who is completely removed from the situation whose personal interests are in no way at stake. Sarbanes-Oxley makes even more sense when applied to this situation.

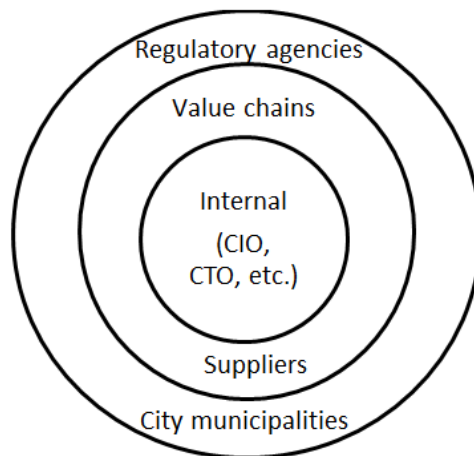
KPMG, September 26

Kirsten Hill
Managing Director, Advisory – Technology Enablement
Dallas, TX

Summary of the information

Managing stakeholder relationships is a necessity for any profitable company. A stakeholder is anyone who is impacted by, or has an impact on, your company. It is very important to pay attention to what your stakeholders think of your company, as well as why they think what they do. Keep in mind that your stakeholders have stakeholders too; the best stakeholder relationships are those that are mutually beneficial. Once you identify your key stakeholders, it is helpful to analyze them in this way:

- 1) Do a target analysis, like the one shown below:



- 2) Do an impact chart, like the one shown below:

Stakeholders	Area of Interest		
	Quality	Cost	Time to Market
Supplier 1		✓	✓
Supplier 2		✓	✓
Customer 1	✓	✓	
Customer 2	✓	✓	✓

This chart shows that cost is the most important concern in the given situation.

- 3) Do a Priority Table, like the one shown below:

Stakeholders	Help	Hurt	Action
Supplier 1	✓		
Supplier 2		✓	
Customer 1	✓		✓
Customer 2		✓	✓

What I learned

I learned that people who have an impact on a company are just as much stakeholders as people who are impacted by that company. I had never even thought about it. The third chart, the priority table, was something I had never even heard of before in concept, but is so useful. Being able to know which of your stakeholders is going to help you solve a problem, and who is going to be difficult about it – and managing those relationships accordingly – is huge when trying to get opinions on an issue, as well as maintaining good relationships with each of them. Having a standardized, but extremely adaptable, way to look at key issues is very helpful when trying to come up with effective solutions quickly.

Center for Intelligence and Security Studies, October 3

Carl Jensen
Director (Former Special Agent, FBI)
University of Mississippi

Summary of the case

We went over how to make sense of, or even sometimes decode, records from various drug dealers. They often leave out labels, units, and markings like dollar signs. Even if they don't try to encode it, it is not recorded the way accountants are used to seeing; sometimes it is not even recorded in a logical manner. Analysts and accountants have to use their knowledge of drug rings, common methods of recording, and accounting in order to make sense of it enough to use it as evidence in a court case. The specific worksheet we encoded in class was recorded in letters instead of numbers, even though it was set up the way numbers would be, with decimal places and obvious addition and subtraction.

Our solution

The solution was a word. The word was *murciélago*, which is the Spanish word for "bat." Each letter translated into a number corresponding to the order of the letters in the word, going from 0 to 9. For instance, "m" (the first letter) translated into the number 0; "g" (the ninth letter) translated into the number 8. This turned the oddly recorded letters into a record of the amount of drugs transported and the payments (both to suppliers and from customers) and balances. From this, we were able to figure out that one pound sold for \$1,000, which was approximately the street price of either marijuana or methamphetamines at the time the entries were recorded. This was then most likely enough evidence to convict the defendant of selling drugs.

What I learned

I learned how necessary accounting is. I hadn't thought about how even drug dealers have to use it in some form, even if that form is encoded or more unorganized than we're used to seeing. I also learned how creative accountants have to be to figure out some of the record-concealment methods of drug dealers, along with other various criminals. Accountants who are good at their jobs are inherent problem-solvers; I had just never thought of it in a detective, crime-solving context.

I also learned about the Center for Intelligence and Security Studies, as well as the Intelligence and Security Studies minor. Ole Miss has one of the only programs of its kind in the country. With the way this presentation went, I'm interested in looking into the program as a potential minor.

Dixon Hughes Goodman, October 10

Chris Glenn

Risk Advisory Services and Internal Audit Practice Leader

Memphis, TN

Summary of the information

Risk advisory services are those that help a company address its risks, both internally and externally. This may include areas such as compliance of both accounting and industry regulations, improvement of business processes, risk management, fraud prevention, and many others. One of the major parts of risk advisory is internal audit. This is when an accounting firm is hired by a company to examine and analyze their systems and controls to identify issues that could be potentially threaten the company's health, profitability, and/or ability to achieve its mission. This analysis would be of employee behavior, internal controls, strategy, reporting, operations, information systems, and many other aspects of the business. The auditors then make suggestions to the company about where the major risks are and what can be done to either lessen them or eliminate them altogether.

There are many additional certifications that someone involved in these fields can obtain, including, but not limited to:

- Certified Internal Auditor (CIA)
- Certified Fraud Examiner (CFE)
- Certified Information Systems Auditor (CISA)
- Certified Investment Management Analyst (CIMA)
- Certified Bank Auditor (CBA)

What I learned

I learned that internal auditing is very closely tied with risk management – I had never thought about the connection between the two before, but it makes sense. Internal risks are just as weighty as external ones (if not more so), and internal audits help a company find those risks and put controls in place to mitigate them. I had previously viewed risk advisory as more external.

I also learned that there are a multitude of other certifications an accountant can have other than CPA, which correlate to the type of accounting he or she is in.

PwC Challenge Case Competition, October 14

Our Mentor:

Lee Thompson
Associate
Birmingham, AL

Summary of the case

Perpetual Energy Group, a fuel producer based in Texas, is focusing more on sustainability. The company is considering the development of a biodiesel facility in El Paso. Its main goal is to enhance sustainability, but its additional goals include:

- 1) Adding a revenue stream
- 2) Using economical raw materials to develop products
- 3) Implementing safe and environmentally sound processes and practices
- 4) Increasing profitability

Analyze this investment from three different perspectives:

- 1) **Environmental** – Who are the key stakeholders? What are the potential environmental issues? What are the benefits?
- 2) **Social** – Who are the key stakeholders? What are the social implications associated with this project? Where might this project create social or community benefits?
- 3) **Financial** – What are the financial implications of this project? Remember, our goal is to articulate in financial terms the long-term sustainability value this project will create for our shareholders, our company, and our world.

Our solution

Perpetual Energy Group has seen that producing biodiesel is more sustainable than using one hundred percent fossil fuels, is more environmentally friendly, is approved socially, and, from a financially standpoint, can be profitable. Using up vegetable oil wastes and grease from restaurants and businesses will reduce pollution that contaminates waterways and save taxpayers from having to pay to clean wastes up.

With the demand for biodiesel expected to rise in the near future, it is essential for Perpetual Energy Group to be ahead of the pack on the frontier of developing alternative sources of energy. The next step will come in the form of 2nd generation biofuels, or biofuel produced from non-food crops. Because the demand for biodiesel is expected to rapidly increase, biodiesel manufacturers will start using up enough of the food crops to cause a food shortage. Since suitable farmland that can grow the food crops is shrinking,

producing too much 1st generation biodiesel is dangerous. 2nd generation biofuels is the solution.

One prime location to grow the raw materials for this new biofuel is in Central America; Perpetual Energy Group will form strategic alliances with Central American countries. They will provide the countries with 1st generation biodiesel in order to harvest their 2nd generation biodiesel crops, which they will buy in order to make the new biodiesel.

While Perpetual Energy Group is producing their 1st generation biodiesel, we recommend that they begin/continue to research more about 2nd generation biofuels and start producing it as soon as they can. Since Perpetual Energy Group is using a loan to finance its current biodiesel production, it can use its excess cash to invest in 2nd generation biofuels.

In conclusion, Perpetual Energy Group can address the environmental, social, and financial needs of its local and world environment by starting to produce 1st generation biodiesel, helping to grow Central America, and eventually producing 2nd generation biodiesel.

What I learned

I learned a lot about the future of biofuel. With the dwindling sources of natural fuel left on our planet, an alternative energy will be needed not too far into the future. As of right now, soy bean oil, animal fat, and recycled fry oil are the main sources of biofuel. However, there isn't enough farmland to grow enough soy to sustain the predicted biofuel demand over the next 30 years. This means there will be a need for a second generation of biofuel. This second generation is still in the very early, experimental stages; however, it is something that every fuel company must be thinking about.

I also learned that most of the best solutions are not easy ones, but ones that are creative and make you step out of your comfort zone. I also learned that sometimes, you have to tell the client bad news about their plan; however, that's part of what they're hiring you for, as a consultant, and in the end they will appreciate it more if you are upfront about it.

Deloitte, October 17

Allen Bradley
AERS Advisory Manager
Memphis, TN

Aaron Michael
AERS Advisory Consultant
Memphis, TN

Summary of the information

Audit and Enterprise Risk Services is split into two categories: audit and advisory; consulting is another related branch. Advisory is split into technology risk; business risk; and accounting, valuation, & analytics services. The main purpose of business risk services is to improve effectiveness and efficiency, and to offer recommendations to improve operations. Technology risk services analyze technologies that manage risk, as well as find solutions for managing the risk associated with technology itself. Accounting, valuation, & analytics services apply technical accounting standards, financial reporting, and valuation techniques. Audit, on the other hand, is a regulatory requirement which is a fixed contract that is generally performed annually. Consulting is similar to advisory but tends to focus more on developing innovative solutions around human capital, strategy, and operations.

What I learned

I learned a lot more about the types of advisory. Whenever I heard advisory mentioned, it was always as a side note to the “tax or audit?” question. I had no idea advisory had so many distinct and very developed branches. I hadn’t even thought about the possibility of a technology risk evaluation, but it makes so much sense—with the ever-developing technology used by businesses—that businesses would need to make sure that the technology was performing all the control operations and checks correctly (such as user accounts and passwords, or having to log in before making changes to a document), as well as making sure all the bases were covered in case the technology or system was damaged so that the information would not be lost. In business these days, information tied to technology is a *huge* risk, completely deserving of an entire branch of accounting advisors.

Horne, October 24

Emily Parrish
Senior Manager
Jackson, TN

Summary of the case

External audit requirements for journal entry testing:

1. Understand the financial reporting process and **controls** over journal entries.
2. Identify and select journal entries and other adjustments for testing.
3. Inquire of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries.

Narrow the focus of journal entry testing by asking who, what, when, where, and why; as well as some any other methods you deem fit.

Our solution

We can narrow the focus of our journal entry testing by looking for specific things and asking specific questions.

For example:

Who?	IT – there is no reason IT should be making an entry, so that would be a red flag
What?	Entries that don't balance Manual entries
When?	Bank holidays Weekends Right around Christmas / the Holidays After or before bank hours During an employee's vacation time
Where?	Petty cash fund Accounts with a ton of entries – it would be easier to hide an entry User accounts accessed from a different computer than the one the user usually uses
Why?	Personal gain Desperation

We can look at any entries that are recorded as “plug.”

We can also use Benford's law to look at the numbers in the entries. We can graph Benford's law (minimum and maximum) alongside the actual to see if something doesn't correlate. For example, if Benford's law estimates that between 11.5% and 13.5% of the values should begin with the number 3, and in actuality 20.8% of the values start with 3, that would be a good place to look.

What I learned

I learned that journal entry testing exists. I never really knew how a lot of auditing worked, but this is a great way to narrow down the search, because looking through every single entry would be a waste of effort and would take way too long (years, really). I also learned about Benford's Law, which I found very interesting. I had no idea numbers could be tested in that way, but it's a great and simple way to narrow the testing.

I also learned that talking to all employees (especially lower-rank) about suspicious behavior or questionable entries is a necessary way to help catch fraud. Employees, who work at the company year-round, will be instrumental in figuring out which entries look wrong or stick out, or any suspicious activity they might have noticed while working.

Pfizer, October 31

Valerie Hall
Corporate Accounting and Analysis
Memphis, TN

Bradley Baker
Staff Accountant
Memphis, TN

Justin Dill
Senior Finance Lead
Memphis, TN

Summary of the case

Calculate the Abandoned and Unclaimed Property (AUP) penalty for a first-time reporting company in Tennessee with an annual liability of \$50,000 per year for aged outstanding checks to vendors without ongoing relationships.

Our solution

The calculations should be done according to the State of Tennessee Treasury Department's penalty calculation sheet. The first step is to calculate the penalty for failure to perform reporting duties. Since it's a first time reporter, you would start with 10 years, and then add 5 years for the accounts payable/vendor payments dormancy period. The penalty for failure to perform reporting duties is the lesser of \$25 per day or \$1,000 per year. In this case, the penalty will be $\$1,000 \times 15 \text{ years} = \$15,000$. Next you have to calculate for failure to pay. The value of securities not reported on time is \$0, but the value of cash not reported on time is \$50,000 a year for 15 years, which comes out to \$750,000. \$0 plus \$750,000 is \$750,000, which is the subtotal delinquent property. You would then multiply \$750,000 by 10% for the first year not reported (\$75,000), by 10% again for the second year not reported (\$75,000), and 5% for the third year not reported (\$37,500). The sum of these three is \$187,500. This part of the fine will be the lesser of this number and \$50,000; therefore, the penalty for failure to pay will be \$50,000 plus \$750,000, or \$800,000. The total penalty will be this \$800,000 plus the \$15,000 penalty for failure to perform reporting duties: \$815,000 total.

What I learned

I had no idea there were so many types of abandoned and unclaimed property. When they originally introduced the topic – a topic completely new to me – my first thought was “lost and found.” However, there is a lot of semi-tangible property; it includes not just

inventory left in a warehouse, but uncashed checks, accounts payable, insurance claim checks, workers compensation, and a bunch of other items.

I learned that almost every company has unreported and un-escheated property, and that the fine for this is potentially detrimental to a lot of companies. In the state of Delaware, which incorporates over half the companies in the U.S., the fine is even higher than in most states, because the penalty is almost invariably calculated back to 1981. Not only this, but because most companies don't have records back to 1981, the state of Delaware makes hefty assumptions in regards to the amount of abandoned and unclaimed property, making the penalty as much as 4 times the amount it would be in another state. For example, the total penalty calculated with interest for the same company described above, but using Delaware's calculation sheet, ends up being \$3,647,000! So while Delaware has the benefit of having very lax incorporation laws, a lot of companies can get hit hard with a penalty like this.

KPMG International Case Competition, November 4

Betsy Sights
Campus Recruiter
Memphis, TN

Tom Avent
Partner, Tax – in charge of Mergers & Acquisitions
Atlanta, GA

Kirsten Hill
Managing Director, Advisory – Technology Enablement
Dallas, TX

Kelly Lomax
Senior Manager
Memphis, TN

Scott Kay
Memphis, TN

Summary of the case

Evaluate the recent acquisition of Cadbury by Kraft. Revenues haven't grown as much as predicted from the acquisition, on top of viewpoint clashes between the two companies. Identify existing and potential problems and provide solutions and suggestions.

Our solution

This presentation examines the acquisition of Cadbury by Kraft Foods. The corporations are still in the transitioning stage, and we believe that moving forward, the corporation should try to create a fresh corporate culture that is sensitive to the two different corporations and the differences in their two countries. The presentation covers three specific ways that Kraft Foods can better consolidate the newly acquired corporation and expand globally. We believe that, initially, Kraft foods should try building bridges and a sense of togetherness and focus less on consolidating financially, at the risk of ostracizing Cadbury and all other related parties.

Our three concerns and areas of focus include:

1. Culture and Respect
This involves minimizing job loss, respecting cultural attitudes and differences,

and moving forward to build the two corporations together.

2. Globalization

This relates to how Kraft can move forward, growing in developing markets that resulted from the acquisition, while also maintaining and building a North American market for the two corporations. This also relates to how Kraft can consolidate distribution chains globally.

3. Finances

This implies a comparison of the financial histories of the two corporations and how this can be used to merge the two companies better in the future. This includes an examination of cash flow, debt, revenue growth, and overall savings between the two corporations.

We believe that, in order to better transition the corporations into one homogenous corporate family, Kraft should make a commitment to building a global company culture within the two corporations that will facilitate growth and expansion on the international level. Kraft should implement all three aspects of this presentation in the short term, as it continues through the transitioning process. Our emphasis on culture and public relations over more effective consolidation is necessary for Kraft to form a cohesive bond with Cadbury in the future.

What I learned

I learned that mergers and acquisitions aren't just about reconciling financial statements and filling out paperwork. They are much more complicated than that. They are about integrating two different companies, with all their employees, strategies, systems, and controls. A lot of times, two companies won't mesh very well at first. Reconciling two different ways of doing business is a delicate and important process. Success cannot be expected without it.

I also learned how to better provide my own direction. This case was left very open as far as direction; really, the only instructions were "analyze this decision." It was difficult to figure out where to start. We started with a SWOT analysis, and then analyzed the current problems, potential problems, priorities, and realistic solutions; this approach really helped us figure out a game plan.

Victoria Dickinson, November 7

Dr. Vicki Dickinson
Professor, Patterson School of Accountancy
University of Mississippi

Summary of the case

Complete a financial statement analysis and a stock evaluation on Kroger using its 2013 financial statements (provided). Calculate the return on equity (ROE), net operating profit before and after tax (NOPBT and NOPAT), net operating assets (NOA), operating return (RNOA), net operating profit margin (NOPM), net operating asset turnover (NOAT), current ratio, quick ratio, debt to equity ratio, times interest earned, and weighted-average cost of capital (WACC). Forecast revenues and then complete both the discounted cash flow model and the residual income model to determine whether to buy or sell Kroger stock.

Our solution

We started by completing all the calculations.

$$\text{ROE} = \frac{\text{Net income}}{\text{Average stockholders equity}} = \frac{1497}{(4214+3966)/2} = 36.6\%$$

NOPBT = \$2764 (taken from Balance Sheet)

We can calculate the tax rate by dividing tax expense (\$794) by earnings before tax (\$2302) to get 34.5%

$$\begin{aligned}\text{Tax on operating profit} &= \text{tax expense} + (\text{pretax net non-operating expense} \times \text{tax rate}) \\ &= 794 + (462 \times .345) = \$953\end{aligned}$$

$$\begin{aligned}\text{NOPAT} &= \text{NOPBT} - \text{tax on operating profit} \\ &= 2764 - 953 = \$1811\end{aligned}$$

Operating assets total \$22,875 in 2013 and \$21,953 in 2012, taken from the Balance Sheet

Operating liabilities total \$11,559 in 2013 and \$11,345 in 2012, taken from the Balance Sheet

Net operating assets (operating assets minus operating liabilities), therefore, equal \$11,316 in 2013 and \$10,608 in 2012.

$$\text{RNOA} = \frac{\text{NOPAT}}{\text{Avg NOA}} = \frac{1811}{(11,316+10,608)/2} = 16.52\%$$

$$\text{NOPM} = \frac{\text{NOPAT}}{\text{sales}} = \frac{1811}{96,751} = 1.87\% \text{ (the average across the U.S. is 6\%)}$$

$$\text{NOAT} = \frac{\text{Sales}}{\text{Avg NOA}} = \frac{96,751}{10,962} = 8.826 \text{ (the average across the U.S. is 1.4)}$$

$$\text{Current ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{7959}{11,057} = .7198$$

$$\text{Quick ratio} = \frac{\text{Cash} + \text{Marketable Securities} + \text{Accounts Receivable}}{\text{Current Liabilities}} = \frac{2244}{11,057} = .2029$$

$$\text{Debt to equity} = \frac{\text{Total Liabilities}}{\text{Stockholders Equity}} = \frac{2734 + 6145}{4207} = 2.11$$

$$\text{Times interest earned} = \frac{\text{NOPBT}}{\text{Interest Expense}} = \frac{2764}{462} = 5.98$$

The risk-free rate at the time was 2.5% and Kroger's beta was 0.70, while the market premium was 6%.

$$\text{Cost of equity (r}^e\text{)} = 2.5 + (0.70 \times 6) = 6.7\%$$

$$\text{Cost of debt} = \frac{\text{Current Assets}}{\text{Current Liabilities}} = 5.42\%$$

$$\text{After tax cost of debt (r}^d\text{)} = \text{cost of debt} \times (1 - \text{tax rate}) = 5.42 \times (1 - .345) = 3.55\%$$

$$\text{WACC} = \left[\frac{\text{Equity}}{\text{Debt} + \text{Equity}} \times r^e \right] + \left[\frac{\text{Debt}}{\text{Debt} + \text{Equity}} \times r^d \right] = 4.56\%$$

$$\text{NNO} = \$8,879 \text{ (Balance Sheet)}$$

Next we forecast sales growth, assuming a 4% growth rate over the next 4 years and then a 1% growth rate indefinitely.

	<i>Reported</i>	<i>Forecasted</i>				
	2013	2014	2015	2016	2017	Terminal
Sales growth	7.06%	4%	4%	4%	4%	1%
NOPM	1.5%					
NOAT	8.00					

With these growth rates in mind, we predict future revenues.

	<i>Reported</i>	<i>Forecasted</i>				
	2013	2014	2015	2016	2017	Terminal
Sales	96,751	100,621	104,646	108,832	113,185	114,317
NOPAT	1,811	1,509	1,570	1,632	1,698	1,715
NOA	11,316	12,578	13,081	13,604	14,148	14,290

Discounted Cash Flow Model:

		1	2	3	4	
FCFF	650	676	703	731	760	768
Discount factor		0.95636	0.91462	0.87471	0.83653	
PV of Horizon FCFF		646	643	640	636	

Cum. PV of Horizon FCFF	2,656
PV of Terminal FCFF	21,553
Total firm value	24,118
Less NNO	8,879
Firm equity value	15,239
Shares outstanding	520
Stock value per share	\$29.31

Residual Income Model:

	1	2	3	4	
Required return	516	574	597	621	646
ROPI	993	996	1,036	1,077	
Discount factor	0.95636	0.91462	0.87471	0.83653	
PV of Horizon FCFF	950	911	906	901	

Cum. PV of Horizon FCFF	3,667
PV of Terminal FCFF	30,004
Total firm value	33,671
Less NNO	8,879
Firm equity value	24,792
Shares outstanding	520
Stock value per share	\$47.68

The actual stock price at the time was \$34.20. The Discount CF Model serves as a lower bound, while the Residual Income Model serves as an upper bound. If for any reason the stock price is lower than the Discounted CF Model value, BUY the stock. If the stock price is higher than the Residual Income Model value, SELL the stock. Because the current stock price is in between the two values, more work must be done to make the decision; as in all cases, it is up to the discretion of the owner with some risk.

What I learned

I learned that a lot of the information on the financial statements goes into valuing stock. You can't just look at a few simple ratios and make an educated guess. There are very developed formulas, methods, and models (using all parts of the statements) used to calculate how much stock should be worth, regardless of what it is currently selling for on the market. However, even two similar methods of calculations can give a wide range of values (\$29.31 to \$47.68). Therefore, a lot more calculations (and sometimes just owner preference) must be put into predicting stock and deciding whether to buy, sell, or keep it. Even with these very developed methods, there is no way to value stock that is that specific. That's why it is still sometimes a guessing game. However, I did learn how essential accounting is to all aspects of business, even predicting the stock market. I can't imagine doing this kind of calculation with only a rudimentary knowledge of financial statements and accounting procedures. Accountants just see things differently when it comes to evaluating a business; they know how things relate to each other, which is more than just helpful for a stock evaluation; it is essential. I also learned some new calculations that focus on net values, which are deemed to be more accurate, and I'm sure I'll see many times more in the future.

Ernst & Young, November 14

Jason Honeycutt
Partner – Business Tax Services
Memphis, TN

Emily Edwards
Recruiter
Nashville, TN

Summary of the case

Asbat Pharmaceuticals is a leading pharmaceutical company that has been in existence for 22 years. It only operates in the U.S. and is not subject to state or local income taxes. Its total assets, not including the deferred tax asset, are \$3.5 million. At first, Asbat operated at a net loss. After the release of its first drug, about five years after the company was started, it began reporting net profits. It was doing so until 2011, when it once again started to report a net loss, which has mostly been caused by extensive R&D costs.

Asbat's statutory tax rate is 35%. The company did not have any permanent book-tax differences between 2011 and 2013 and there will be no reversal of taxable temporary differences in the next 5 years. Loss figures for 2011-2013 are included in the case packet, but the pretax book loss for 2013 is \$775,000 and the tax benefit is \$309,750.

Asbat has 100,000 share of common stock outstanding. The analyst forecast for net loss per share is \$5. Currently, Asbat is assessing its need to record a valuation allowance to offset the deferred tax asset created by the NOL carryforward. Management anticipates net income in the future, as they are in the final stages of developing a new drug that has tremendous market potential.

The CFO has made a five year profits forecast (attached in case packet). He has been with the company a long time and his earnings predictions have been very reliable.

Use the information provided to determine whether or not a valuation allowance should be recorded, and what amount it should be. Be sure to perform a full analysis using the professional judgment framework.

Our solution

The primary issue is whether or not there should be a valuation allowance, and what the amount should be. There is a bias towards meeting or exceeding the analyst's loss predictions which we must be aware of. The application guidance is the four sources of income. There are no reversals of existing taxable temporary differences in the next five

years. There was no taxable income in prior carryback years, and no tax planning strategies. Therefore, the source must be future taxable income. Other necessary information comes from the forecasts and industry expert opinions. Because the CEO has made accurate predictions in the past, the information seems reliable. However, in order to maintain professional skepticism, someone else should be consulted about the income forecasts. In addition, someone else in the industry should be consulted about the drug, potential competition, and the risk of failure. The forecasts are based on the assumptions that the drug will be a success, the forecast is correct, and the tax rate is the same in the future. However, there is a strong possibility that the drug will fail or major competitors will emerge. If the drug fails, the income loss is predicted to continue for the next five years. In light of this, we believe a full valuation allowance should be established. Therefore, the valuation allowance should be \$309,750, the amount of the 2013 tax benefit.

What I learned

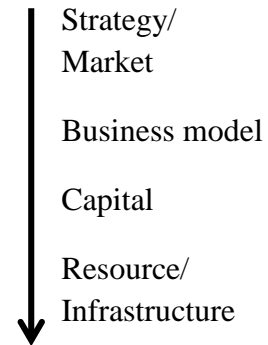
I learned how unpredictable a net operating loss carryforward is. I had previously thought that it would be easy to assume a company would make a profit in the next 20 years, with how long of a time that was. However, more than 5-10 years is very unpredictable (in fact, some companies don't even survive that long). And in the next 5-10 years, unless there is a major change in the company, it's almost impossible to turn a profit into a loss. In the case of Asbat, the new drug *could* do that. However, it's just as likely that the drug will fail – there is a 93% fail rate in the drug industry – and the company will not be able to make annual profit, and will therefore never be able to use the tax benefit. That's why it's very important to have a valuation allowance, in case the net operating loss carryforward expires without use. I also learned how important it is to maintain professional skepticism by keeping potential management biases in mind and getting second opinions. That's a good mindset to have, especially as an auditor.

Harbor View Advisors, November 21

Chris Haley
Principal
Jacksonville, FL

Summary of the information

Entrepreneurial Lifecycle



1. Idea

This idea must solve a problem or fulfill a need. The goal is to see something no one else sees. This idea doesn't necessarily have to be new. The best ways to get validation for an idea are to ask people who know what they're doing (use your network) and to ask potential customers. There are a lot of factors that decide whether or not your idea will be successful. These include luck, passion, networking, and funding.

2. Development

In order to develop your product or service, you must prepare a business plan. This plan must cover everything from financing to potential markets to a timeline. SWOT analysis would be helpful in preparing this business plan. Next you'll have to do some marketing. As an example, this could be done by handing out samples. Then you'll have to get feedback on the samples or other tests of your product. You can get feedback from the testers, potential customers, and your network. Word of mouth is really helpful for marketing and other aspects of development. Once you can show that you can repeat the process of selling and receiving customer satisfaction, people will want to finance you.

3. Commercialization

Commercialization is pretty straightforward, though not simple. You need to make people believe that they need it. A good question to ask is: How much is it worth to the customer?

4. Growth (*the most important stage*)

The goal of this stage is to obtain controlled growth so that there won't be issues arising from failure to keep up with demand. The unfortunate fact of entrepreneurship is that most ventures fail. An important thing to remember in order to keep your company in the successful few is that an interesting product means nothing if the service isn't good. Another important aspect is company culture. This part is super necessary; you need your employees to feel supported and motivated, otherwise they will not be an asset to your company.

5. Scale

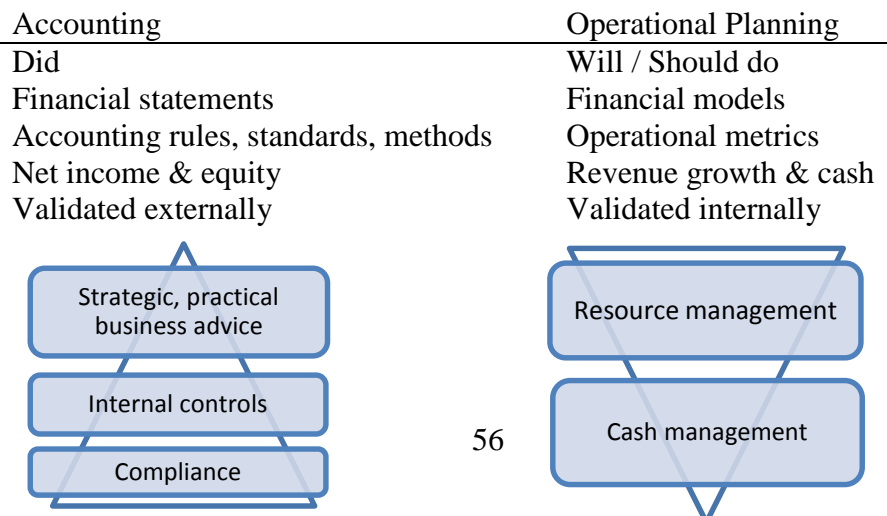
There must be different, or adaptable, processes and procedures for each level of revenue. What works for a \$100 K revenue scale will not work for a \$100 M revenue scale. You also have to always pay attention to keeping economies of scale. These, too, will be different at different levels, but they can reduce a lot of cost if used properly. You will need to be making constant adjustments to ensure that you are working as smoothly and efficiently at \$20 M as you were at \$10 M.

6. Monetization

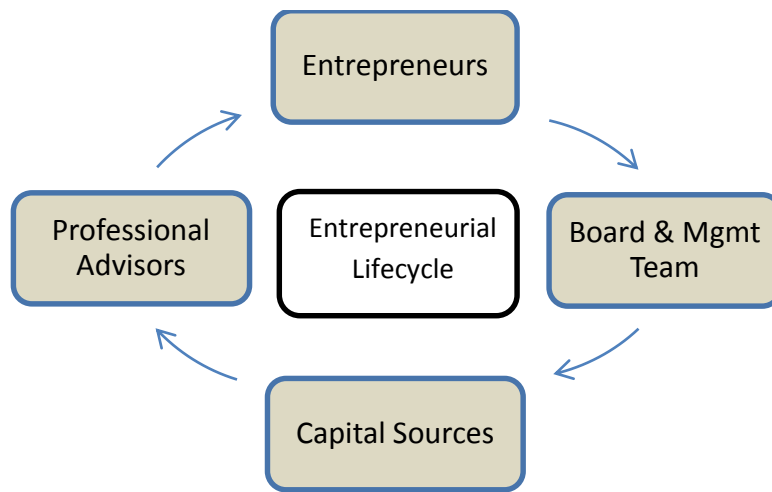
This step is all about how you turn your business into cold, hard cash. This is your exit, or your liquidity. There are three ways to monetize a business. The first is to sell the company; this is most common with small companies. The second is to go public with an IPO (initial public offering); this choice is better with big companies. The third choice is to keep operating (or potentially expand) and live off the cash flows. An important thing to do before selling the company (if that's what the best choice is) is to figure out the value of the company. A model such as a Residual Income Model or Discounted Cash Flow Model could be used. Another option is just to see what a willing buyer and the seller will negotiate, considering the value of a company is based on what people will pay for it. One last point to be addressed is when the right time to monetize a company is. The answer all depends on the owner/founder's preference, especially in the case that they need the money for another use. Another good time to sell would be when the offer is unbelievable.

Accounting's Role

1. End game
 - Operate?
 - Grow?
 - Lens through which client views planning
 - Helps decide priority items
2. Numbers



3. Roles



Keep entrepreneur honest, but help make his/her ideas happen

Be able to do more than just recite the code; be able to apply it to the situation in a way that makes sense to someone without an accounting background

What I learned

I learned a lot of general success advice from Chris Haley:

Read everything. No matter what profession or life experience you end up in, reading more and learning more will help you be more capable, helpful, well-rounded, and self-sufficient.

Build a professional network as soon as possible and as expansive as possible. Find interesting people, people who are determined and will work their way up the ranks of whatever company they work for, and people of all different professions and industries. You never know when they will be able to help you, whether they just give you their opinion on an idea or give you a job at their company.

Be a professional psychologist. Figure people out, listen to their problems and help them work them out. That's one of the best things you can do in a professional advisory role like an accountant.

Live your life asking the question: "How am I going to be different?"

I also learned a lot about what you can do with an accounting background besides public accounting. It really reinforced that you can do anything in business with an accounting

degree. As one option, I learned a ton about entrepreneurship and working with start-up companies in different industries and at different stages.

FedEx, December 5

Janet Tarver
International Tax Manager
Memphis, TN

Sylvia Ballard
International Tax Manager
Memphis, TN

Summary of the information

U.S. transfer pricing deals with the evaluation of prices charged in transactions between related parties in different jurisdictions. Transfer prices should be on an arm's length basis, which means they should be set as if the parties were not related. Transfer pricing influences the company's profits and the country tax base because it transfers taxable profits from one jurisdiction to another. There are large penalties for not complying with, or not showing extensive documentation of, transfer pricing according to tax code. There are six main transfer pricing calculation methods; three are transaction-based, three are profit based. The transaction-based methods are the Comparable Uncontrolled Price Method (CUP), the Resale Price Method, and the Cost Plus Method. The CUP Method compares the amount charged in a controlled transaction to the amount charged in an uncontrolled transaction. The Resale Price Method compares the gross profit margin realized in a controlled transaction to that of an uncontrolled transaction. The Cost Plus Method looks at the gross profit markup of a controlled transaction compared to that of an uncontrolled transaction. The three profit-based methods are the Comparable Profits Method (CPM), the Transactional Net Margin Method (TNMM), and the Profit Split Method (PSM). The CPM compares the objective measures of profitability (as calculated by profit level indicators, or PLIs) of a controlled transaction versus an uncontrolled transaction by taxpayers who engage in similar activities under similar circumstances. This comparison is challenging, because a company has to go out and find another company that does all of the same things that it does, with all of the relevant factors being the same, to compare itself to. The TNMM also uses these similar companies, or at least similar transactions, as a basis for comparison; however, this method compares net profit margin instead of PLIs. The PSM compares the allocation of the combined operating profit or loss attributable to a controlled transaction to the relative value of each controlled taxpayer's contribution to that combined operating profit or loss. Each of these six methods is correct in certain conditions, and there is no hierarchy. When used, each method will likely give a different answer. Sometimes these answers can be close, but sometimes they are very different. Therefore, extensive research must be done to justify using one method over another. This research must be documented, not only for the

method chosen, but also for the rejection of the other methods. Keeping good documentation of this process, though usually extensive, is less expensive than IRS audit defense and the penalties that can be imposed. In the U.S., this penalty can be up to 40% of the tax adjustment for a gross valuation and 20% for substantial valuation. There are ten principle documents used in a transfer pricing study, with a typical study format. Transfer pricing studies are required for both countries involved in the transaction. Because of the time and extensive research required for these studies, a sample documentation package (essentially a blank template of the transfer pricing study) is extremely helpful, especially because it can easily be adapted for different countries. The IRS has really cracked down on transfer pricing, which is seen as “shopping for best tax deals,” in hopes that it will be a solid new source of revenue in this economic crisis. With the hefty penalties, unprepared companies make this true. That’s why it’s so important to extensively document transfer prices charged. Because FedEx operates in every country, matching revenues to expenses (an important accounting practice) is a complex procedure. Each of the different pieces of FedEx shipping services has its own costs, which must be matched to the overall revenue realized for the service. FedEx has done an impressive job of not only accomplishing this matching with every package shipped, but also having extensive accurate documentation of procedures used for transfer pricing, and successfully defending this documentation in every country.

What I learned

I never thought that what a company charged itself (or a subsidiary, sister company, or mother company) in a different country would make a difference. However, the differing tax codes in countries across the globe make this issue understandable. I learned the “arm’s length” rule, which is the basis behind transfer pricing. It actually makes a lot of sense. Charge this company (or this section of your company in a different country) the same price you would charge anyone else, and justify that price. Still, the extensiveness of this process for companies like FedEx that do business in so many countries and can have a single package shipped across two to three, to even four countries, is shocking. I also didn’t think about how the crucial concept of revenue and expense matching would play into a company like this, who incurs revenue in one place and expenses in a bunch of others. FedEx’s “per package” revenue credits and expenses is a genius idea, and its standardization seems to work very well for them. Lastly, I learned how transfer pricing, like many other concepts in accounting, is such a gray area. There are many methods which are all deemed correct in different situations, and it’s up to the company to decide which method to use, and to back that decision up with evidence.